

Report of the auditor-general to the Eastern Cape Legislature and council on the Amathole District Municipality

Report on the audit of the consolidated and separate financial statements

Adverse opinion

1. I have audited the consolidated and separate financial statements of the Amathole District Municipality and its entity set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2020, consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, because of the significance of the matters described in the basis for adverse opinion section of this auditor's report, the consolidated and separate financial statements do not present fairly, in all material respects, the consolidated and separate financial position of the Amathole District Municipality as at 30 June 2020, and the consolidated and separate financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 16 of 2019 (Dora).

Basis for adverse opinion

Property plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment, as the municipality did not maintain an accurate and complete asset register that agrees with the amounts disclosed in the consolidated and separate financial statements. In addition, restatements made to the opening balance were not supported and disclosed in the note to the consolidated and separate financial statements. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether adjustments were necessary to property, plant and equipment stated at R4,5 billion (2019: R4,4 billion) in the consolidated and separate statement of financial position and depreciation, amortisation and impairment stated at R128,5 million (2019: R124,8 million) in note 31 to the consolidated and separate financial statements.

Payables from exchange transactions

4. Payables from exchange transactions of R563 million (2019: R475 million) was disclosed in note 20. The municipality's processes for recording and recognising payables from exchange transactions were insufficient as amounts either did not agree with the supporting documentation or were not recorded. Consequently, trade payables was overstated by R41 million (2019: R146 million). Due to the lack of systems, it was impracticable to determine

the full extent of the overstatement of trade payables. Furthermore, sufficient appropriate audit evidence could not be obtained as supporting documentation was either not submitted for audit purposes or, where the documentation was submitted, it was found to be incomplete. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to trade payables as disclosed in note 20 to the consolidated and separate financial statements.

Inventory consumed

5. Inventory consumed of R257 million was disclosed in note 36. The municipality's processes for recording and recognising inventory consumed was insufficient as amounts either did not agree with supporting documentation or were not recorded. Consequently, inventory consumed was understated by R74 million. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of inventory consumed. Furthermore, sufficient appropriate audit evidence could not be obtained as supporting documentation was either not submitted for audit purposes or, where the documentation was submitted, it was found to be incomplete. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to inventory consumed, as disclosed in note 36 to the consolidated and separate financial statements.

Unauthorised expenditure

6. The municipality incorrectly calculated unauthorised expenditure in the current year resulting in unauthorised expenditure, as disclosed in note 46 to the consolidated and separate financial statements, being understated by R167 million (2019: R391 million).

Repairs and maintenance

7. The municipality did not have a system in place to accurately record repairs and maintenance expenditure. The expenditure recognised in repairs in maintenance should have been capitalised to property, plant and equipment. Consequently, repairs and maintenance disclosed in the consolidated and separate statement of financial performance was overstated by R89 million and property, plant and equipment in the consolidated and separate statement of financial position was understated by R89 million.

Revenue from exchange transactions- service charges

8. The municipality did not recognise and account for revenue from exchange transactions in accordance with GRAP 9, *Revenue from exchange transactions*. This was due to inadequate systems in place for revenue management, as revenue was billed using incorrect consumption units or incorrect rates. Furthermore, adjustments were processed in debtor's accounts resulting in revenue being recognised in an incorrect accounting period, which overstated revenue. In addition, some customers were not billed during the year. Consequently, service charges was overstated by R44,8 million (2019: R39 million) and receivables from exchange transactions was also overstated by R51,5 million (2019: R45 million) and VAT payable was overstated by R6,7 million (2019: R5,8 million) in the consolidated and separate financial statements.

Cash flow statement

9. The municipality did not prepare the consolidated and separate cash flow statement in accordance with GRAP 2, *Cash flow statements*. The municipality incorrectly calculated the consolidated and separate net cash flow from operating activities, which resulted in a material understatement of R421 million.
10. In addition, the corresponding figure for consolidated and separate cash flows from operating activities contained misstatements in the following line items, which were not addressed by the municipality:
 - Receipts from service charges was understated by R102,5 million
 - Receipts from government grants and subsidies was understated by R72,5 million
 - Other receipts was understated by R78,4 million
 - Payment of employee-related costs was overstated by R61,1 million
 - Payment to suppliers was understated by R41,7 million.

Statement of comparison of budget and actual amounts

11. The municipality did not accurately disclose the budget and the actual amounts, as required by GRAP 24, *Presentation of budget information in financial statements*. The budgeted amounts disclosed in the consolidated and separate financial statements did not agree with the approved budget. As a result, the budgeted revenue was overstated by R14 million and the budgeted expenditure by R73 million.

Corresponding figures

Revenue from non-exchange transactions – government grants and subsidies

12. The municipality did not account for revenue from government grants and subsidies in accordance with the requirement of GRAP 1, *Presentation of financial statements*. Expenditure incurred in the previous financial years was incorrectly accounted for by including it in revenue in the current financial year. As a result, revenue from government grants and subsidies was overstated by R29,2 million in the consolidated and separate statement of financial performance.
13. In addition, the municipality did not maintain complete and accurate records of accounting for revenue from conditional grants. Supporting documentation was not obtained for transactions that were recorded as expenditure incurred. Consequently, I was unable to determine whether any further adjustments were necessary to revenue from government grants and subsidies of R621,1 million and the related unspent conditional grants of R64 million, disclosed in notes 28 and 17 to the consolidated and separate financial statements respectively.

Operational costs

14. The municipality did not have a system in place to accurately record operational costs. The operational costs recognised were recorded in the incorrect accounting period. As a result, operational costs was overstated by R64 million in the consolidated and separate statement of financial performance and payables from exchange transactions was understated by R64 million in the consolidated and separate statement of financial position.

Interest earned on outstanding receivables

15. The municipality did not account for interest earned on outstanding receivables in terms of its policies. This was due to differences identified in recorded amounts and approved rates used for calculating interest. As a result, the interest earned on outstanding receivables is overstated by R40,7 million in the consolidated and separate statement of financial performance and receivables from exchange transactions is understated by R40,7 million in the consolidated and separate statement of financial position.

Aggregation of immaterial uncorrected misstatements

16. Total liabilities is materially misstated by R25,6 million due to the cumulative effect of individually immaterial uncorrected misstatements in non-current liabilities of R10,2 million and current liabilities of R15,4 million.

Context for the opinion

17. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
18. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA code) as well as other ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
19. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse opinion.

Emphasis of matters

20. I draw attention to the matters below. My opinion is not modified in respect of these matters

Restatement of corresponding figures

21. As disclosed in note 44 to the consolidated and separate financial statements, the corresponding figures for 30 June 2019 were restated as a result of an error in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2020.

Material uncertainty relating to financial sustainability

22. I draw attention to the matter below. My opinion is not modified in respect of this matter:
23. I draw attention to note 58 to the consolidated and separate financial statements, which indicates that the municipality is facing a number of financial risks including the inability to pay creditors within due dates and the inability to collect revenue billed. Furthermore, the municipality is in a net current liability position. As stated in note 58, these events and

conditions cast significant doubt on its ability to sustain its current level of operations in the near future.

Events after reporting date

24. I draw attention to note 58 to the consolidated and separate financial statements, which indicates that the municipality has been placed under a mandatory provincial intervention under section 139 (5)(a) of the Constitution of the Republic of South Africa.

Other matters

25. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure note

26. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Unaudited supplementary schedules

27. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion on them.

Responsibilities of the accounting officer for the financial statements

28. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
29. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the consolidated financial statements

30. My objectives are to obtain reasonable assurance about whether the consolidated and separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in

accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.

31. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to this auditor’s report.

Report on the audit of the annual performance report

Introduction and scope

32. In accordance with the Public Audit Act 25 of 2004 (PAA) and the general notice issued in terms thereof, I have a responsibility to report on the usefulness and reliability of the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.

33. My procedures address the usefulness and reliability of the reported performance information, which must be based on the municipality’s approved performance planning documents. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures do not examine whether the actions taken by the municipality enabled service delivery. My procedures also do not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

34. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected strategic objective presented in the municipality’s annual performance report for the year ended 30 June 2020:

Strategic objective	Pages in the annual performance report
KPA 2 – basic service delivery and infrastructure development	x – x

35. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
36. The material findings in respect of the usefulness and reliability of the selected development objectives are as follows:

Key performance area 2 – basic service delivery and infrastructure development

Various indicators

37. The reported achievements in the annual performance report did not agree with the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievements of these indicators were as follows:

Indicator	Reported achievement	Audited value
% of water infrastructure refurbished as per implementation plan SD1/2	Target not achieved: 60% was achieved against 80% that was targeted for the year, the appointed contractor struggled financially and opted to cede the work to financially stronger company so as to salvage the project. Unfortunately this also did not yield desired outcomes	40%
No. of households with access to basic level of sanitation (VIP toilets) SD2	25 815 households are supplied with new VIP toilets against 10 000 on target. Beneficiary certificates of acceptance with the service provider`s signature as a sign of completion are availed. Supporting evidence is availed	28 683

Various indicators

38. I was unable to obtain sufficient appropriate audit evidence for the achievement against reported targets in the annual performance report. This was due to the lack of accurate and complete records. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement for the targets listed in the table below.

Performance Indicator	Reported value
% increase in sampling frequency	50%
% of wastewater infrastructure refurbished as per implementation plan (Butterworth & Fort Beaufort WWTW)	40%

Percentage increase in sampling points coverage SD1/4

39. Included in the performance indicator: *percentage increase in sampling points coverage* is a planned target: *percentage increase in sampling coverage*. The achievement of this planned target was recorded as 30%. While some supporting evidence provided materially differed from the reported achievement, there were other instances where I was unable to obtain sufficient appropriate audit evidence in support of this achievement. This was due to the lack of accurate and complete records. I was unable to confirm the reported achievement by

alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievement.

Other matters

40. I draw attention to the matters below.

Achievement of planned targets

41. Refer to the annual performance report on pages... to... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraph 37 to 39 of this report.

Adjustment of material misstatements

42. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of basic service delivery and infrastructure development objective. As management subsequently corrected only some of the misstatements, I raised material findings on the reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

43. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the municipality's compliance with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

44. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements, performance and other reports

45. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements on revenue from non-exchange identified by the auditors in the submitted consolidated and separate financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving an adverse audit opinion

Strategic planning and performance management

46. The performance management system and related controls were inadequate as they did not describe how the performance planning, monitoring, measurement, review and reporting processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).

Expenditure management

47. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
48. An adequate management, accounting and information system that recognised expenditure when it was incurred and accounted for creditors was not in place, as required by section 65(2)(b) of the MFMA.
49. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the unauthorised expenditure incurred, as indicated in the basis for qualification paragraph. The majority of the disclosed unauthorised expenditure was caused by spending exceeding the main segments within the budget and not budgeting for non-cash items.
50. Reasonable steps were not taken to prevent irregular expenditure of R103,8 million, disclosed in note 48 to the annual consolidated and separate financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-adherence to the supply chain management (SCM) legislation.
51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R1,9 million, as disclosed in note 47 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties on late payments

Revenue management

52. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.
53. An adequate management, accounting and information system that accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
54. Revenue due to the municipality was not calculated monthly, as required by section 64(2)(b) of the MFMA.

Conditional grants

55. Performance in respect of programmes funded by the water service infrastructure grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of Dora.

Asset management

56. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
57. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

Procurement and contract management

58. Some contracts and quotations were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
59. Awards were made to providers who were in the service of other state institutions or whose directors or principal shareholders were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44.

Other information

60. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the audit committee's report. The other information does not include the consolidated and separate financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.
61. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion on it.
62. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
63. The other information was not received prior to the date of this auditor's report. After I receive and read this information, and if I conclude that there is a material misstatement, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and reissue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

64. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
65. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls and compliance with laws and regulations. The significant internal control deficiencies noted were not conducive to an effective internal control

environment. Furthermore, leadership did not insist on daily disciplines that ensure sound financial and performance management and compliance with laws and regulations. The audit intervention plan has not been effectively monitored and implemented to ensure that the previous year's external audit findings were addressed and do not recur during the year under review.

66. Management did not design and implement daily and monthly controls to ensure the consolidated and separate financial statements and annual performance reports were supported by accurate and complete underlying records. Management also did not prepare regular accurate and credible financial and performance information that would be incorporated in the consolidated and separate annual financial statements and annual performance reports. Further, management did not implement an efficient records management system to ensure that financial and non-financial information was easily retrievable.

Other reports

67. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's consolidated and separate financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the consolidated and separate financial statements or my findings on the reported performance information or compliance with legislation.
68. The Office of the Public Protector conducted an external investigation into allegations of maladministration, corruption and tender irregularities in the procurement process of ventilated improved pit (VIP) toilets. The investigation was completed, tabled to council and the municipality is currently implementing recommendations from the investigation.
69. An external investigation into the alleged irregular acquisition of the fully integrated financial management system was conducted by National Treasury and completed in October 2019. The investigation was completed, tabled to council and the municipality is currently implementing recommendations from the investigation.

Auditor - General

East London

16 April 2021



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the consolidated and separate financial statements and the procedures performed on reported performance information for selected key performance areas and on the municipality’s compliance with respect to the selected subject matters.

Consolidated financial statements

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error; design and perform audit procedures responsive to those risks; and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the consolidated and separate financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists relating to events or conditions that may cast significant doubt on the ability of the Amathole District Municipality to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify my opinion on the consolidated financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease operating as a going concern
 - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and determine whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
 - obtain sufficient appropriate audit evidence regarding the financial information of the entities to express an opinion on the consolidated and separate financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, the actions taken to eliminate threats or the safeguards applied.